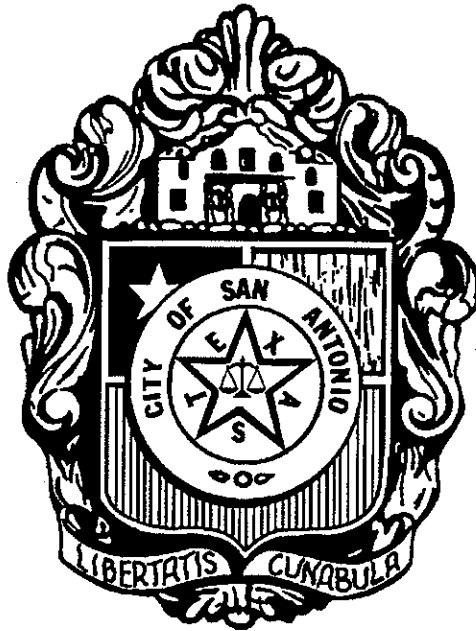


Convention Center Hotel Advisory Board



First Report

August 27, 2003

Prepared by City of San Antonio Economic Development Department 210.207.8088

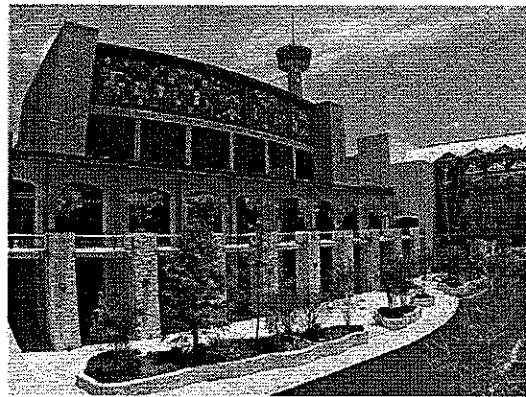
Project Background

The City of San Antonio seeks to strengthen its position among the nation's leading convention destinations and continue to develop the downtown area as one of the leading cultural, entertainment, and commercial centers in the United States.

As such, the City has been pursuing qualified developers capable of developing a premier, full-service convention center hotel adjacent to the Henry B. Gonzalez Convention Center.

The development site contains more than 118,000 square feet and is ideally located at the north entrance of the Convention Center, along the San Antonio Riverwalk and wraps around the Lila Cockrell Theater (pictured).

The proposed hotel will accommodate additional conventions, convention delegates and maximize the utilization and return on investment of the Convention Center as well as enhance utilization of existing hotel rooms through growth in convention business and visitor industry activity.



Respondents to City's Request for Qualifications

In 2002, the City issued a Request for Qualifications (RFQ) to a broad list of nationally recognized development companies. Five developers responded to the RFQ.

- Hines Interests, LP
- Landmark/FaulknerUSA
- Mesirow Stein
- Related Lodging
- Ryan Companies

Convention Center Hotel Advisory Board

In February 2003, the City Council established the Convention Center Hotel Advisory Board (CCHAB), which is composed of seven local experts from the Finance/Banking, Real Estate/Corporate, and Hotel/Tourism business sectors as well as a community representative. After becoming familiar with the project and financing issues, it is envisioned that the CCHAB could assess and make recommendations to the City Council on the following topics:

- Developer capabilities
- Project financial design
- Project timing

In March 2003, the City Council appointed the following individuals to the CCHAB:

<u>Finance/Banking</u>	<u>Real Estate/Corporate/Hotel</u>	<u>Community</u>
Ruben M. Escobedo	Henry Feldman	Richard Terrell
Adam Garza	Juli Galloway*	
Joe C. McKinney*	<i>Vacant</i>	

* The Board selected Ms. Galloway as Chair, and Mr. McKinney as Vice-Chair.

Advisory Board: Fact-Finding Phase

Since April, the Advisory Board has convened nine meetings and called on City Staff from the Economic Development and Finance Departments, Convention and Visitors Bureau, and the City Manager's and City Attorney's Offices as well as hotel consultants the City's financial advisors, industry experts and bond underwriters. The Advisory Board has deliberated on the following five issues:

1. the need for building a new convention center hotel;
2. the viability of a new hotel;
3. the ideal scope of the hotel;
4. the potential cost of development; and
5. the project financing options.

Issue 1: Is a Convention Center Hotel Needed?

The strength of San Antonio as a meetings destination includes the appeal of a diverse array of things to see and do, major attractions, history, culture, golf, cuisine, arts, and other elements that include a fun and friendly atmosphere.

Planners have cited the central U.S. location; mild year-round weather; and critical mass of centrally located and functional meeting facilities, hotels and attractions. There is also limited need for shuttles/busing since the city has great walkability and accessibility. The newly-renovated airport services key domestic and international destinations, and its close proximity to downtown provides for easy and inexpensive transport.

According to the SACVB, meeting planners consistently point to their desire to place more delegates (in larger blocks) at fewer hotel properties. In addition, many of the City's core convention clients continue to grow their association memberships. Larger meetings not only require an expanded center, but the availability of larger blocks of hotel rooms.

Other Texas cities are developing new hotel properties that will provide direct competition to San Antonio as a leading convention destination. These projects include:

- Austin Hilton Hotel, 800 rooms
Opening December 2003
- Houston Hilton Americas, 1,200 rooms
Opening December 2003
- Grapevine Gaylord Opryland Hotel, 1,511 rooms
Opening April 2004

The proposed convention center hotel goes hand-in-hand with the investment the city has already made in the expanded and renovated convention center, and will strengthen the ability to sell San Antonio. Moreover, many convention clients require that their meetings be held in a single hotel and San Antonio is often eliminated from consideration because of its inability to provide a property or more than one property of suitable capacity.

Recommendations/Next Steps:

Despite all the city's advantages, San Antonio operates in an extremely competitive meetings business environment, and must continually improve its product offerings in order to retain and increase market share. As a result of these attributes, the Board has concluded that a convention center hotel is vital to the continuing success of San Antonio as a competitive meeting destination.

Issue 2: Is the Project Viable?

The City's hotel consultant, PKF Consulting, was asked to conduct a project feasibility study. Based on research of the competitive lodging market, PKF concluded that a full-service convention center hotel of up to 1,500 rooms could be viable.

Despite the current slowdown in the national visitor industry, PKF estimated that the hotel could stabilize in the third year of operation (2009), reaching an occupancy level of 78% and an ADR (Average Daily Rate) of \$189.00 (\$154.00 expressed in 2002 constant dollars).

The Advisory Board also examined the overall state of the convention industry to assess the long-term growth of demand for hotel rooms at both a national and local level. The Advisory Board also received a variety of other reports from City Staff and industry experts.

Recommendations/Next Steps:

The Advisory Board has determined that a 1,500-room hotel might be too risky for the City to pursue as a development objective given the current market conditions and possible municipal requirements for project requirements. The Board recommends that the project scope not exceed 1,200 rooms.

In considering hotel financing scenarios, the Advisory Board heard from the City's financial advisor, Coastal Securities, on the critical balance between hotel size and possible financial risks to the City. The Advisory Board believes that the City's project goals must be tempered by market and financial concerns that must be taken into account when determining the ideal size for the proposed hotel.

For these reasons, the Advisory Board believes it would be more prudent for the City to develop a convention center hotel that would range up to 1,200 guestrooms. The exact size of the hotel will be narrowed after further meetings with financial underwriters and potential developers.

Issue 3: What is the Ideal Scope of the Hotel?

This is not just another hotel project for San Antonio. It is a critical component of infrastructure for the meetings industry. It will allow the CVB to market the City as it never has before. As such, the hotel should be a signature project that will enhance the City's status as a leading convention destination.

Recommendations/Next Steps:

In order to meet certain minimum standards that would attract conventions and keep the city competitive with other leading destinations, the Advisory Board concurs that an ideal hotel project should include:

- Up to 1,200 hotel guestrooms;
- first-class, full service amenities;
- large capacity meeting and food and beverage facilities (minimum 90,000 square feet to include a 40,000-square foot ballroom and/or a 25,000-square foot junior ballroom);
- adequate size parking garage for city and hotel use;
- nationally recognized hotel operator;
- premier national and international marketing and sales operation;
- room block agreement for a minimum 800 rooms;
- hotel employees paid a living wage as defined by City Council;
- convenient and easily accessible interface with Riverwalk and Convention Center.

Issue 4: What is the Cost of Development?

According to data provided by PKF Consulting, it was suggested that in today's market, a first-class premier convention center hotel would cost about \$200,000 per room to design, construct and furnish.

Recommendations/Next Steps:

Using this rule of thumb, the following cost estimates could be used in determining the cost of development for a San Antonio convention center hotel.

<u>1,000 Rooms</u>	<u>1,200 Rooms</u>	<u>1,500 Rooms</u>
\$200,000,000	\$240,000,000	\$300,000,000

However, there are additional and significant financing expenses that are not included in these figures, which will be incurred. These additional financing costs may range from \$40,000 to \$75,000 per guestroom.

Issue 5: What are the Project Financing Options?

In July, the Advisory Board heard from two underwriting firms: US Bancorp Piper Jaffray and UBS Financial Services, Inc. These firms have actively participated in other municipal hotel financings. The following information summarizes the three financing options for a hotel.

I. Private Ownership: 100% Private Financing

- Owner/operator provides equity
- Debt is raised via banks or capital markets
- May include public incentives such as tax abatements

II. Private Ownership: Public Sector Cash Subsidy

- Owner/operator provides equity
- Some debt is raised via banks or capital markets
- Financing “gap” remains after equity and available debt are determined
- Public sector is needed to provide cash subsidy in the form of public debt financing

III. Public Ownership: Public Financing using Tax-Exempt Bonds

- Host municipality establishes Hotel Corporation or such entity to own/operate hotel
- Corporation contracts with hotel manager to operate hotel for “fixed” annual fees
- Corporation selects developer or project manager to build facility
- Municipality issues tax-exempt bonds to finance construction
- IRS regulations do not permit a private sector party to invest equity or receive “equity-like” returns

Recommendations/Next Steps:

The Advisory Board has not yet made its recommendations regarding project financing options. The Advisory Board has received reports indicating that conventional hotel financing may be difficult to achieve. Some form of municipal or non-profit debt financing may be required to ensure development. The amount of debt design, structure and issuance, credit enhancement and risk has not yet been determined.

As a matter of policy, the Advisory Board recommends that the City seek as much private equity contribution as possible while minimizing the City's long-term risk. To that end, the Advisory Board, as part of its assessment of developers, plans to interview RFQ Respondents to determine the industry's viewpoints on private financing.

The Advisory Board feels that determining a sound, viable financing structure is a high priority in developing the hotel. As a next step, it is recommended that an underwriting/legal team be immediately selected to evaluate optimal financing structure and participate in evaluation of development teams.

Next Steps

- Brief City Manager, Management Team, Mayor and City Council
- Seek City Council Approval of CCHAB Recommendations
- Select Underwriter and Bond Counsel (Proposed)
- Issue Developer Request for Proposals (RFP) in late 2003
- Recommend Preferred Developer to City Council
- Negotiate Development Agreements